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INVESTMENT COUNSEL

GLOBAL SMALL CAP SPECIALISTS

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"I think you have to learn that there is a company behind every stock, and that there is only one real reason why stocks go up. Companies go from doing poorly to doing well, or small companies grow to large companies."

– Peter Lynch

Truth told, there are plenty of things that keep me awake at night – family issues, business issues, impact of COVID-related stress on everyone around me, whether the Blue Jays will make the wild card. But one of the most persistent thoughts is wondering what owners of capital – our industry's clients – actually think we do for them. As we are regularly compared to our peers, I wonder whether our role is to outsmart other market participants, or is our role to find positive, return-generating investment ideas and put clients' money to work in them?

Of course, it's not really an either/or question, but given the fixation that both we and our clients have for benchmarks, peer groups and all manner of market data mining and number crunching, it seems clear that the 'outsmart' goal gets by far the more attention.

The marketing forces underlying change to allocation (at a cost, of course) have presented these owners of capital with a plethora of investment and economic ideas: changing demographics, interest rate direction, smart beta, cyclical equities, passive funds, enhanced ETFs, funds-of-hedge-funds, impact investing…the list goes on and on. For those of us with considerable time invested in our industry, we are torn between sadness about what our industry has become and a sort of anxious optimism the world will eventually believe that investing means something altogether different.

Part of this fascination for the next shiny investment idea is derived from the continued impatience of the investor. Investment holding periods that were measured in years decades ago, are now measured in days. Average annual equity portfolio turnover has now risen above 100%, meaning the entire portfolio has been sold and repurchased each year. So much for Warren Buffett's ideal holding period "….forever".

We do clients an injustice by frequently buying and selling shares to each other – playing the 'outsmart' game. We would do our clients a great service by helping companies deploy their capital in return-generating projects, encouraging management to implement well, exercise patience, and act to achieve long-term objectives. Surely this is what investing should really be about, rather than (or as well as) the industry's tick-box obsession with executive compensation and share structures?

In the capitalist system, investment managers exist to help providers of capital allocate it to those who will put it to good use; generally, entrepreneurs with good ideas but lacking funds to put them into action. New technologies and business models are created which improve upon and displace the old; economic and social infrastructure are created to support society. Risks are involved – some ideas and projects are successful, and some aren't. Through the wonders of entrepreneurial activity, creative destruction and innovation, economic progress is made, living standards rise and 'returns' are generated for investors.

This divergence away from "investing", as defined above, has resulted in an avalanche of regulatory pressure and industry criticism. Our industry has created its own monster by forgetting our role. We and our clients focus on the wrong things – we measure ourselves on benchmark-relative and peer-relative performance instead of by reference to actual investment returns and meeting client need.

Speak with someone you know well, who knows enough to understand that their pension is invested somewhere, but who works somewhere far outside the investment industry. Ask them what they think we (our industry) do with their money and listen to their answer. Then think about what really drives the industry's day-to-day decisions and come to your own conclusion about whether we are fulfilling our primary obligations.